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IN THE

Supreme Court of the United States

October Term, 1942

No. 857

The France Stone Company,
Petitioner,

vs.

Commissioner of Internal Revenue,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT AND BRIEF IN SUPPORT THEREOF

John J. Kendrick,
7th Floor Home Bank Bldg.,
Toledo, Ohio,
Attorney for Petitioner.

Fraser, Effler, Shumaker & Winn,
7th Floor Home Bank Bldg.,
Toledo, Ohio,
Of Counsel.

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To the Honorable the Chief Justice and Associate Justices of the Supreme Court of the United States:

Your petitioner, The France Stone Company, respectfully represents and shows to the court:

SUMMARY STATEMENT OF THE CASE

This case involves petitioner's federal income tax liability for the calendar year 1937. The particular type of tax which is the subject of the controversy is the tax commonly known as the undistributed profits tax which was first imposed upon corporations by the Revenue Act of 1936.

Petitioner is an Ohio corporation with its principal place of business at Toledo. It is engaged in the business of crushing stone for railroad ballast, concrete construction, highway building and similar building trades and uses (R. 93). Early in 1933 the taxpayer's capital structure was revised (R. 93). Thereafter the capital structure of petitioner was as follows (R. 94):

8,000 shares cumulative preferred stock — non-voting;

10,000 shares Class A common stock having a par value of $100 per share and entitled to a dividend of $6.00 per share per year—non-voting;

10,000 shares no par value Class B common stock which was voting stock. Stated value of the B stock was $1,000.

The new preferred shares were represented by new certificates and one of the provisions under which said new preferred shares were issued, and which appeared on the preferred stock certificates, was in part as follows (R. 94):

> "After providing for the payment of the cumulative dividend then due on the preferred shares and before any dividends are declared, paid or set aside to or for other shareholders, the Directors shall set aside from the remaining surplus earnings for each year a sum equal to 5% of the par value of all of the preferred shares then outstanding, as a Sinking Fund to be held and used for the redemption of the preferred shares as hereinafter provided, and for no other purpose. This Sinking Fund provision shall be cumulative so that if in any year, the surplus earnings of the corporation shall be insufficient for the purpose of setting aside the aforesaid amount so provided for the Sinking Fund, then no dividend shall be paid to, or declared or set aside for, any shareholders other than the preferred shareholders."

Up to December 31, 1937, dividends were paid annually upon the preferred shares (R. 28).

Dividends of 10 cents a share were paid on the Class

A common stock in 1937, since the corporation desired to continue its dividend record, it having paid a dividend upon its common stock since its beginning (R. 94-95).

No dividends were paid upon the Class B common stock during the year 1937.

The taxpayer sustained net losses for several of the years prior to 1936 and during that time made no provision for meeting its sinking fund requirements with respect to the redemption of its preferred stock. According to the terms and provisions of the preferred stock issue the amounts required to be set aside as a Sinking Fund to be held and used for the redemption of the preferred stock aggregated $385,000 to January 1, 1937. The amounts actually set aside for the fund up to that date amounted to $263,000. During 1937 petitioner increased this Sinking Fund by the amount of $37,000, which brought the total amount actually set aside to $300,000 as of December 31, 1937 (R. 95-96).

For the calendar year 1937 respondent determined that the correct net income of petitioner for federal income tax purposes was in the amount of $123,410.20. Respondent also determined that the adjusted net income of petitioner for the purpose of computing the surtax on its undistributed profits for the year 1937 amounted to $111,379.81. Respondent allowed as a dividends paid credit and as a reduction of said adjusted net income for the purpose of computing petitioner's undistributed profits surtaxes, the sum of $44,807.50, representing cash dividends paid to petitioner's stockholders during the calendar year 1937 and thus computed an undistributed net income subject to surtaxes of $66,572.31, with a resulting surtax of $10,747.62, the amount of the tax deficiency in controversy in the case (R. 9, R. 33, R. 96). Petitioner claims that it is entitled to a credit of $111,379.81 against its adjusted net income for the purpose of computing surtaxes on undistributed

profits, said credit being computed as follows (R. 28):

Cash dividends paid during 1937........	$ 44,807.50
Credit for contracts restricting dividend payments under Section 26(c) (1) of the Revenue Act of 1936..............	66,572.31
	$111,379.81

The credit claimed by petitioner of $66,572.31 under Section 26(c) (1) of the Revenue Act of 1936 was based upon the contract above referred to between petitioner and its preferred shareholders which restricted and prevented petitioner from paying dividends during the year 1937 as hereinbefore specifically set forth. Respondent limited the dividends paid credit to the dividends actually paid by petitioner during the year 1937 and refused to allow any credit on account of petitioner's contract with its preferred shareholders (R. 96).

Petitioner appealed from respondent's determination to the United States Tax Court (formerly United States Board of Tax Appeals) and that court concluded that petitioner's contract with its preferred stockholders did not constitute a contract within the meaning of Section 26(c) (1) of the Revenue Act of 1936 and upheld respondent's determination (R. 98). Petitioner then filed a petition for review with the United States Circuit Court of Appeals for the Sixth Circuit (R. 99) which court on February 9, 1943, affirmed the decision of the United States Tax Court (R. 103 and R. 104).

OPINIONS BELOW

The Circuit Court of Appeals rendered no opinion in this case but merely entered an order of judgment which may be found at page 103 of the record.

The opinion of the United States Tax Court is set forth in the record on page 93.

JURISDICTION

The jurisdiction of this court is invoked under Section 240 of the Judicial Code as amended by the Act of Congress approved February 13, 1925, Chapter 229, Section 1, 43 Stat. 938 (Title 28 United States Code, Section 347).

STATUTE INVOLVED

The case involves the meaning and application of Section 26(c) (1) as amended by Section 501 of the Revenue Act of 1942, which provides in part as follows:

> "Sec. 26. Credits of Corporations. In the case of a corporation the following credits shall be allowed to the extent provided in the various sections imposing tax— * * *
>
> (c) Contracts Restricting Payment of Dividends.
>
> (1) Prohibition on Payment of Dividends. An amount equal to the excess of the adjusted net income over the aggregate of the amounts which can be distributed within the taxable year as dividends without violating a provision of a written contract executed by the corporation prior to May 1, 1936, which provision expressly deals with the payment of dividends. If a corporation would be entitled to a credit under this paragraph because of a contract provision and also to one or more credits because of other contract provisions, only the largest of such credits shall be allowed, and for such purpose if two or more credits are equal in amount only one shall be taken into account."

THE QUESTION PRESENTED

Is the contract between petitioner and its preferred shareholders which was entered into by petitioner prior to May 1, 1936, such a contract as is contemplated by Section 26 (c) (1) of the Revenue Act of 1936, as amended by Section 501 of the Revenue Act of 1942, so as to entitle petitioner to a credit of $66,572.31 against its undistributed net income for 1937?

REASONS RELIED UPON FOR ALLOWANCE OF WRIT OF CERTIORARI

1. The decision of the United States Circuit Court of Appeals is in direct conflict with the decision of the United States Circuit Court of Appeals for the Third Circuit in the case of *Lehigh Structural Steel Company vs. Commissioner* (March 27, 1942), 127 F. 2d 67. The Commissioner of Internal Revenue, respondent herein, filed no petition for writ of certiorari for review of the decision of the Circuit Court of Appeals for the Third Circuit in the Lehigh Structural Steel case.

2. The decision of the United States Circuit Court of Appeals is probably based upon an erroneous interpretation of and is probably in conflict with the rule of law announced by this court in *Helvering vs. Northwest Steel Rolling Mills, Inc.* (1940), 311 U. S. 46, and *Crane-Johnson Company vs. Helvering* (1940), 311 U. S. 54.

3. The decision of the United States Circuit Court of Appeals is in direct conflict with the purpose and intent of the amendments to Section 26 of the Revenue Act of 1936 as enacted by Congress in Section 501 of the Revenue Act of 1942.

4. The precise questions here involved have never been before this court, and in view of the decision of this court in *Helvering vs. Northwest Steel Rolling Mills, Inc., supra,* and in view of the retroactive amendments to the Revenue Act of 1936 by Section 501 of the Revenue Act of 1942, it is submitted that the same are of such general importance that this court should announce the rules of law properly applicable thereto.

WHEREFOR, your petitioner prays that a writ of *certiorari* issue under the seal of this Honorable Court directed to the United States Circuit Court of Appeals for the Sixth Circuit commanding that court to certify and to

send to this court for review a full and complete transcript of the record of the proceedings in cause No. 9774 entitled on its docket "*The France Stone Company, Petitioner, vs. Commissioner of Internal Revenue, Respondent,*" and that said judgment of the United States Circuit Court of Appeals may be reversed by this Honorable Court and that your petitioner may have such other and further relief in the premises as to this Honorable Court may seem proper.

John J. Kendrick,
Attorney for Petitioner.

Fraser, Effler, Shumaker & Winn,
700 Home Bank Building, Toledo. Ohio,
Of Counsel.